information about those dealings.[23] These incidents do not involve disputed issues of fact or otherwise require the Commission to exercise judgment. In § 271 application after § 271 application, the BOCs have openly refused to comply with the Commission's repeated admonitions that they fully disclose their dealings with their affiliates as mandated by § 272(b)(5). The Commission has thus far been unable to ensure compliance with this basic cornerstone of Congress' § 272 affiliate regime. Moreover, the fact that the BOCs have refused to disclose this critical information makes it very likely that other abuses have gone undetected, as § 272's disclosure requirements are primarily intended to deter and detect violations of the Act's requirements.

The above examples are only the beginning. Among other abuses that have been detailed in the § 271 proceedings before the Commission to date:

- BOCs have entered into collocation arrangements with their § 272 affiliates that are discriminatory on their face.[24]

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[23] See, e.g., Comments of AT&T Corp. in Opposition to BellSouth's Second Section 271 Application for Louisiana, CC Docket No. 98-121, at 80 (filed Aug. 4, 1998); Comments of AT&T Corp. in Opposition to Pacific's Proposed Section 271 Application, Calif. PUC, Calif. PUC, R.93-04-003, I.93-04-002, R.95-04-044, at 68-70 (filed April 30, 1998); Comments of AT&T Corp. in Opposition to BellSouth's Section 271 Application for South Carolina, CC Docket No. 97-208, 55-57 (filed Oct. 20, 1997); Investigation Into U S WEST Communications, Inc.'s Compliance with Section 271(c), of the Telecommunications Act of 1996, Montana PSC, Docket No. 97.5.87, Prehearing Brief of AT&T Communications of the Mountain States, Inc., at 29 (filed Aug. 10, 1998) ("U S WEST has provided only minimal records of transactions with its affiliates").

[24] Comments of AT&T Corp. in Opposition to BellSouth's Second Section 271 Application for Louisiana, CC Docket No. 98-121, Tab O, Affidavit of P. McFarland, ¶¶ 42-46 (filed Aug. 4, 1998) (noting that BellSouth/BSLD physical collocation agreement provides for facially discriminatory term commitments not offered to other CLECs).

- One BOC "loaned" at least $90 million to its § 272 affiliate pursuant only to an oral agreement that specified no payback term and no interest rate.[25]

- One BOC issued a tariff that, although neutral on its face, discriminated in favor of its § 272 affiliate by providing substantial discounts and free network management services only if the customer accepted term and growth commitments that only an affiliate would find attractive.[26]

- BOCs repeatedly have failed to comply with the basic Internet posting requirements for transactions with their § 272 affiliates, with most largely ignoring this requirement until shortly before they file applications for interLATA relief, and even then making inadequate disclosure.[27]

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25 Comments of Teleport Communications Group, Inc. in Opposition to Ameritech's Section 271 Application for Michigan, CC Docket 97-137, at 32-33 (filed June 10, 1997) [CHECK CITE].

26 Comments of AT&T Corp. in Opposition to Ameritech's Section 271 Application for Michigan, CC Docket No. 97-137, Exhibit O, Aff. of D. Goodrich and L. McClelland, ¶ 42 (filed June 10, 1997). The tariff, issued by Ameritech, provided beneficial discounts and services only if the customer made a five-year commitment to provide 100% of all growth in business to Ameritech, maintained all current service with Ameritech, and converted current service to sixty-month plans). See FCC Transmittal No. 1040 (filed Dec. 27, 1996).

27 See, e.g., Comments of AT&T Corp. in Opposition to BellSouth's Second Section 271 Application for Louisiana, CC Docket No. 98-121, at 81-82 (filed Aug. 4, 1998) (noting that BellSouth's Internet site, besides providing inadequate information, did not contain any information regarding certain transactions until after BellSouth filed its application); Comments of AT&T Corp. in Opposition to Pacific's Proposed Section 271 Application, Calif. PUC, R.93-04-003, I.93-04-002, R.95-04-044, Tab [ ], Affidavit of R. Kargoll , ¶¶ 38-44 (filed April 30, 1998) (showing that information on Pacific's Internet site was inadequate, and noting that Pacific had not posted any information until after December 1997); Comments of AT&T Corp. in Opposition to BellSouth's Section 271 Application for South Carolina, CC Docket No. 97-208, 55-57 (filed Oct. 20, 1997); Investigation Into U S WEST Communications, Inc.'s Compliance with Section 271(c), of the Telecommunications Act of 1996, Montana PSC, Docket No. 97.5.87, Rebuttal Testimony of T. Million, U S WEST, at 11 (filed July 31, 1998) (stating U S WEST'sposition that it intends to post information on the Internet only once it receives interLATA authority).

- One BOC admitted having engaged in transactions with its § 272 affiliate that violated the requirement that they operate independently, but refused to disclose any specific information about these transactions or to explain what (if anything) was done to eliminate and return any unlawful benefits that accrued to the affiliate as a result of these transactions.[28]

- BOCs have violated the requirement that they have separate officers and directors from the § 272 affiliate, by having their parent companies act as the sole director for both the BOC and § 272 affiliate and by refusing to disclose whether officers of the BOC and affiliate report to the same corporate officers within the parent.[29]

- BOCs have refused to institute procedures to identify, end, and "true-up" those past transactions with their § 272 affiliates that were inconsistent with the § 272 and the Commission's implementing orders.[30]

State commissions also have found that the BOCs have failed to comply with § 272. For example, the Texas Commission, after holding extensive open hearings and reviewing thousands pages of comments and exhibits, made the following findings, among others, regarding SWBT's noncompliance with § 272:

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28 Comments of AT&T Corp. in Opposition to SBC's Section 271 Application for Oklahoma, CC Docket No. 97-121 at 36-37 (filed May 1, 1997); see also Brief in Support of Application by SBC for Provision of In-Region, InterLATA Services in California, Calif. PUC, R.93-04-003, I.93-04-002, R.95-04-044, Rehmer Aff. ¶ 14 (filed March 31, 1998) (admitting that "the Telcos did perform certain [operating, installation, or maintenance] functions, such as maintenance and engineering switches or transmission facilities owned by SBLD or PB Com").

29 Ameritech Michigan Order, ¶¶ 353-362; Comments of AT&T Corp. in Opposition to BellSouth's Second Section 271 Application for Louisiana, CC Docket No. 98-121, at 84 (filed Aug. 4, 1998).

30 Comments of AT&T Corp. in Opposition to BellSouth's Second Section 271 Application for Louisiana, CC Docket No. 98-121, at 83-84 (filed Aug. 4, 1998); Comments of AT&T Corp. in Opposition to BellSouth's Section 271 Application for South Carolina, CC Docket No. 97-208, at 58 (filed Oct. 20, 1997); Comments of AT&T Corp. in Opposition to Ameritech's Section 271 Application for Michigan, CC Docket No. 97-137, at 38 (filed June 10, 1997).

- "SWBT's postings on the Internet do not clearly delineate the services which are provided by SWBT to SBLD, the identified interLATA affiliate;"
- "There is insufficient information to evaluate if transactions are fairly and accurately valued;"
- "Transactions between February 1996 and the date of approval to initiate interLATA services shall be disclosed and made subject to 'true-up'"; and
- "[T]he independence and separation of the [§ 272 affiliate's] board and officers from SWBT is not absolutely clear from the record. The record ... shall be further developed ... so that a determination can be made as to whether SBLD's officers, directors, and employees are separate from SWBT and its corporate chain of command."[31]

Following a similar proceeding in California, the Telecommunications Division staff of that state's Commission likewise concluded: "Pacific [Bell] has not provided evidence that it is in compliance with § 272 of the Act."[32] The staff called on Pacific to establish that it was "not using competitors' proprietary information for its own use" and to benefit its § 272 affiliate; to "identify all transactions between itself and its section 272 affiliates ... subject to 'true-up;'" and to "fully explain its valuation procedures and methods."[33] In addition, the staff called on Pacific to "[p]rovide verifiable evidence of separate officers for Pacific and all of its 272 affiliates," noting

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31 Investigation of Southwestern Bell Telephone Company's Entry into the Texas InterLATA Telecommunications Market, Texas PUC, No. 16251, Commission Recommendation, at 16-17 (released June 2, 1998).

32 California PUC Telecommunications Division Initial Staff Report, Pacific Bell (U 1001 C) and Pacific Bell Communications Notice of Intent to File Section 271 Application for InterLATA Authority in California ("CA PUC Staff Report") at 1 (released July 10, 1998).

33 Id., pp. 74-75.

that "the independence and separation of Pacific's and PB Com's [Pacific's § 272 affiliate] boards of directors and officers from SBC is not absolutely clear."[34]

The Commission has yet to find that any BOC either (i) has complied with the § 272 requirements that are in effect prior to its obtaining permission to originate in-region interLATA telecommunications; or (ii) will comply with the other requirements of § 272 if it obtains such permission. Indeed, to date the BOCs have shown undisguised contempt for their § 272 obligations -- despite the fact they currently have every incentive to be on their best behavior as they attempt to satisfy the requirements of § 271. The record before the Commission provides no basis to conclude that the current § 272 rules have been effective even in the context Congress intended, much less that they are adequate to protect against ILEC discrimination and cross-subsidization under the NPRM's advanced services affiliate proposal.

B. Comments On The NPRM's Proposed Restrictions And Safeguards.

As shown above, if the Commission permits ILECs to establish advanced services affiliates that will be deemed non-ILECs for purposes of the Act, it must strengthen its proposed rules in order to ensure that such affiliates are sufficiently separate so as not to be "successors or assigns" within the meaning of § 251(h). Further, as a practical and policy matter, in order to achieve the NPRM's goal of ensuring that advanced services affiliates are "truly separate," the Commission must provide significantly stronger safeguards than those the NPRM proposes.

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[34] Id., p. 75.

1. The Commission should clarify that ILECs must obtain approval before they may provide advanced services through a separate affiliate that is not subject to § 251(c).

The NPRM is silent on the specific procedures ILECs must follow before they could provide advanced services through a separate affiliate that would not be subject to § 251(c). The Commission should make clear an ILEC must obtain Commission certification that both it and its affiliate have complied, and will continue to comply, with the separation and disclosure requirements promulgated by the Commission.[35]

It is crucial that the Commission require a meaningful review and approval process for ILEC advanced services affiliates. As AT&T has shown, the record before the Commission uniformly shows that the BOCs are grossly and openly noncompliant with their § 272 obligations. The BOCs' documented defiance of the law in this area counsels strongly against allowing ILECs to enter the advanced services market through a putatively "truly separate" affiliate without having first demonstrated that they will comply with the Commission's rules. The Commission cannot rely on bare ILEC assurances of compliance -- the record of its § 271 proceedings to date establishes clearly that mere "paper promises" are insufficient to protect consumers and competition.

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[35] Cf. 27 U.S.C. § 271(d)(3) (requiring similar pre-authorization review for the BOCs' § 272 affiliates); Computer III Phase II Order, 2 FCC Rcd 3072 (1987) (requiring BOCs wishing to provide intraLATA Internet access service to first receive Commission approval by establishing that the underlying regulated basic services are available on an equivalent, unbundled basis to unaffiliated ESPs).

In the absence of a "pre-approval" review process, an ILEC and its affiliate could begin to provide advanced services without having first implemented, or even expressly accepted, the separation and disclosure obligations imposed by the Commission. Such violations could go undetected for a substantial period of time -- especially if the ILEC and affiliate do not faithfully follow their disclosure obligations -- and even when detected would go unremedied until final resolution by the Commission or state commissions.[36] While such disputes were pending, an ILEC's failure to meet the Commission's requirements could have a lasting, and possibly irreversible, effect on the rapidly evolving market for advanced services, and on the market for traditional services as well.

In addition, a pre-authorization review process is necessary because, as the Commission recognizes in the NPRM, whatever obligations it imposes as a result of this proceeding will amount only to general guidelines.[37] "A determination as to whether an affiliate is a successor or assign is ultimately fact-based."[38] A myriad of facts and circumstances will bear upon whether an ILEC affiliate should properly be considered a non-ILEC, not all of which can

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36 Although the Commission recently established an "accelerated docket" for complaint proceedings (with AT&T's strong support), those procedures remain untested and disputes concerning ILECs' dealings with their affiliates will not necessarily be amenable to accelerated resolution, as they may involve many disputed issues of fact or substantial volumes of discovery materials. Moreover, in the wake of the Eighth Circuit's decision in Iowa Utilities Board, the scope of the Commission's authority to address matters relating to sections 251 and 252 in complaint proceedings is unclear. See Iowa Utilities Board v. FCC, 120 F.3d 753, 803-04 (8th Cir. 1997), cert. granted, 118 S.Ct. 879 (1998).

37 See NPRM, ¶ 104 n.202 ("[T]here is and can be no single definition of 'successor' which is applicable in every legal context," quoting Howard Johnson Co. v. Detroit Local Joint Executive Board, 417 U.S. 249, n.9 (1974)).

38 NPRM, ¶ 104.

be anticipated before the fact in the abstract context of an NPRM. Absent pre-authorization review and approval by the Commission, an ILEC could avoid the sort of individualized review that is critical to evaluating, for example, whether the affiliate "derives an unfair advantage from its relationship with the incumbent LEC."[39]

2. The general separation requirements and safeguards listed in the NPRM must be broadened and strengthened.

The NPRM seeks comment on a list of structural separation and nondiscrimination requirements that an ILEC advanced services affiliate would have to meet before it could be deemed a non-ILEC.[40] AT&T agrees that each of these requirements, which are modeled on § 272, must be satisfied in order for an ILEC affiliate to even potentially avoid being regulated as an ILEC. A number of these requirements should be clarified and strengthened, however, and further structural separation requirements should be imposed as well.

a. The Commission should require a meaningful quantum of outside ownership of ILEC advanced services affiliates.

To ensure that an ILEC advanced services affiliate is "truly independent," the Commission must establish additional corporate structural separation requirements that aim to induce the affiliate to pursue its own corporate self interest (that is, to act more like a CLEC). These additional separation requirements are critical. Without them, an affiliate necessarily will

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39 Id., ¶ 83. The approval process need not be onerous. Such a proceeding should address all of the elements that are necessary to prove that an ILEC and its affiliate have satisfied their separation obligations, and could be accomplished (with public comment) within 90 days.

40 Id., ¶ 96.

act at the behest of its parent company, its sole shareholder, to further the parent's best interests rather than its own. The parent, in turn, will have every incentive to coordinate actions of the ILEC and affiliate to maximize the sum of their profits, rather than maximizing returns for the affiliate. For example, the parent might cause the affiliate willingly to pay monopoly-level prices to the ILEC for UNEs (because such prices would apply to all CLECs), or to eschew UNEs altogether in favor of resale in order to avoid having to create usable operations support systems for ordering and combining unbundled elements.

As AT&T has stated in prior proceedings, even when an ILEC retains only a minority interest in an affiliate, the ILEC nevertheless will have both the incentive and the opportunity to subsidize its affiliate's operations or engage in other forms of discrimination.[41] Indeed, it is doubtful that anything short of complete divestiture of an ILEC's interest in an affiliate could actually place that affiliate in the same position in the marketplace as a CLEC. At minimum, to ensure that ILEC advanced services affiliates "function just like any other competitive LEC," the Commission should mandate some meaningful quantum of outside ownership of those entities in order for them to qualify for treatment as non-ILECs. In addition, the Commission should require that the affiliate's outside owners be guaranteed representation on the affiliate's board, and that major corporate decisions be approved by at least a majority of outside board members.[42] Indeed, without meaningful outside ownership, there will be no

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41 See, e.g., LCI Petition For Expedited Declaratory Rulings, AT&T Comments, CC Docket No. 98-5, (filed March 23, 1998).

42 Acquisitions of as little as 20% of a competitor's equity are commonly met with antitrust challenges. See, e.g., Denver & Rio Grande W. R.R. Co. v. United States, 387 U.S. 485

(footnote continued on following page)

effective practical or legal means to assure that an advanced services affiliate will function as an independent entity. The Supreme Court has observed that "A parent and its wholly owned subsidiary have a complete unity of purpose. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate consciousnesses, but one."[43] In contrast, outside owners would demand that an advanced services affiliate maximize its own profits by negotiating the most favorable possible terms from its ILEC parent and pursuing strategies designed to maximize the affiliate's return -- as would any "truly separate" enterprise.[44]

b. Transaction disclosure safeguards.

The transaction disclosure safeguards listed in the NPRM should be strengthened and clarified in order to deter discriminatory conduct by the ILEC in favor of its affiliate, and to increase the likelihood of detection when such conduct does occur. First, the Commission should make clear that the disclosure obligations established in this proceeding are effective as of the date that an ILEC or its parents identifies an entity as its intended "advanced services affiliate," not as

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(footnote continued from previous page)

(1967) (upholding Clayton Act challenge and noting that "with [company A] holding 20% of [company B's] stock there is likely to be immediate and continuing cooperation between the companies").

43 Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 771 (1984).

44 "In the parent and wholly-owned subsidiary context ... the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and the parent's shareholders." D. Block, N. Barton, & S. Radin, The Business Judgment Rule: Fiduciary Duties of Corporate Directors, at 185 (4th ed., Prentice Hall 1994) (citations omitted). In contrast, where the parent owns less than 100% of the subsidiary's stock, "the directors of both the parent corporation and the subsidiary corporation owe fiduciary duties to the subsidiary's minority shareholders." Id.

of the date that affiliate is actually certified by the Commission as an advanced services affiliate or actually begins operating as a non-ILEC. As shown above, the BOCs have persisted in arguing that they are not required to comply with § 272 until they obtain § 271 approval, despite the Commission's repeated holdings to the contrary.

Second, the Commission should require disclosure of all transactions between an ILEC and its advanced services affiliate from the date the affiliate was incorporated or established, not merely from the effective date of any order issued in this proceeding. Any other result would permit an ILEC to funnel goods and services into its affiliate at subsidized rates, without fear of detection, in anticipation that the Commission's will later grant that affiliate non-ILEC status.

Third, the Commission should specify that transaction disclosures must include, at a minimum, the rates, terms, conditions, and valuation methods employed by the ILEC and its affiliate, so that the Commission and other parties can meaningfully evaluate them. The Commission also should make clear that ILECs must adhere to the disclosure requirements established in the Accounting Safeguards Order by e.g., posting all information about all transactions on the Internet within 10 days of their occurrence. These clarifications are essential because, as shown above, the BOCs have repeatedly flouted unambiguous Commission rulings requiring these practices under § 272.

Fourth, the Commission should incorporate into any required disclosures a provision modeled on § 272(e), which requires that BOCs not discriminate between their affiliates and other entities in the provisioning process. In order to implement such a requirement, the Commission should require that ILECs provide performance measurements sufficient to allow CLECs to evaluate their compliance with this nondiscrimination requirement. At a minimum, these disclosures should include measurements such as those the Commission proposed in the

FNPRM that accompanied the Non-Accounting Safeguards Order, as well as the additional disclosures AT&T proposed in its comments in that proceeding.[45] As the Commission found in that order, information concerning BOC provisioning is not available from any other source. Without specific disclosure requirements "parties will be unable readily to ascertain how long it takes a BOC to fulfill its own or its affiliates' requests for service."[46]

The need for § 272(e)-type disclosures to deter and detect ILEC discrimination in its provisioning of facilities and services to its advanced services affiliate is strongly underscored by the Minnesota Attorney General's recent complaint to that state's Commission, which alleges that U S West is using its monopoly power over xDSL-equipped local loops to "squeeze out its competition by discriminating in favor of its own affiliate," USWEST.Net.[47] The complaint contends that U S West delayed installation of xDSL services to competitors, but "provided all necessary connections to USWEST.Net, giving its own Internet service a head start and an unfair advantage."[48] The Attorney General requests that the Minnesota PUC establish monitoring and reporting requirements, and require that U S West's "MegaBit" service be made available for resale.

In addition to the above disclosure requirements, the ILEC and affiliate should obtain and pay for an annual audit by an independent auditor selected by the relevant state

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45 Non-Accounting Safeguards Order, Comments of AT&T Corp., filed February 19, 1997.

46 Id., ¶ 242.

47 Communications Daily, September 17, 1998 (Westlaw: 1998 WL 106907307) (quoting Minnesota Attorney General's complaint).

48 Id.

commission, with the first audit commencing six months after the affiliate gains approval to begin operations as a non-ILEC.[49] This auditor must have access to the financial accounts and records of the ILEC and all of its affiliates, and should evaluate compliance with the Commission's rules in a manner modeled on the audit requirement of § 272(d).

3. The same separation requirements should be applied to all ILECs and their affiliates, regardless of their size.

The NPRM also seeks comment on whether the same separation requirements should apply to ILEC advanced services affiliates without regard to an ILEC's size.[50] The Commission already has found in the context of ILEC in-region interLATA affiliates that independent LECs, like their BOC counterparts, "have the ability and incentive to misallocate costs," to "discriminat[e] against the affiliate's interexchange competitors," and to "initiate a price squeeze to gain additional market share."[51] As these holdings recognize, independent LECs also possess market power by virtue of their monopoly control over bottleneck local exchange

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[49] Although § 272(d) provides for a biennial, rather than annual audit, more frequent auditing of advanced services affiliates is essential because, unlike § 272 affiliates, they will be operating in a marketplace that has not yet been irreversibly opened to competition pursuant to the § 271 criteria.

[50] NPRM, ¶ 98.

[51] Second Report and Order, Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, 12 FCC Rcd 15756 (released April 18, 1997), ¶¶ 159-61. For example, the Texas Commission recently ruled that a GTE intraLATA discount plan discriminated in favor of its long distance affiliate. Order on Rehearing, Complaint of AT&T Communicatoins of the Southwest, Inc. Against GTE Southwest, Inc. and GTE Long Distance, PUC Docket No. 15711, SOAH Docket No. 473-96-1101 (June 24, 1997)..

facilities. Accordingly, they should be subject to the same separation requirements as BOC advanced services affiliates.[52]

4. The separation requirements should not be subject to an automatic sunset provision.

AT&T opposes an automatic sunset provision for any separation requirements imposed on ILEC advanced services affiliates.[53] First, a sunset provision would be inconsistent with the obligations imposed by § 251(c). The NPRM proposes separate affiliate requirements chiefly as a means for ILECs to avoid the resale and unbundling obligations that would otherwise be imposed by that section. However, absent the creation and maintenance of an affiliate that met the statutory requirements necessary to be deemed a non-ILEC, an ILEC's advanced services facilities would be subject to § 251(c)'s requirements indefinitely, as that section contains no sunset provision. It would be plainly contrary to the 1996 Act to permit an ILEC to shield its advanced services operations from § 251(c) (or to shield those of an affiliate that was no longer sufficiently separated to be deemed a non-ILEC) simply by virtue of having funneled those services through an advanced services affiliate for a specified period of years.

The Commission also should reject the NPRM's suggestion that it might be appropriate to look to the § 272(f) sunset provision as a model.[54] As discussed above, the

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52 Further, as the NPRM notes, § 251(f) of the Act permits certain small ILECs to obtain an exemption from § 251(c). See NPRM, ¶ 98. Congress thus already has determined the criteria which small ILECs must satisfy in order to escape their § 251(c) obligations, and the Commission should not impose weakened separation requirements on the advanced services affiliates of ILECs that do not qualify for relief under § 251(f).

53 See id., ¶ 99.

54 See NPRM, ¶ 99.

Commission has correctly recognized that § 251(c) and § 272 have "differing underlying purposes."[55] Section 272's sunset provision reflects Congress' anticipation that, three years after a BOC has satisfied the § 271 requirements, increasing competition in the local exchange market would lower the BOC's ability to leverage its local exchange market power into the interLATA market to such an extent that some of the § 272 safeguards might no longer be necessary.[56] This legislative finding stands in direct contrast, however, to § 251(c), which contains no sunset provision of any kind. Plainly, Congress knew how to write sunset provisions, and elected not to do so in the case of § 251(c).

In addition to being contrary to the statutory obligations imposed under § 251(c), imposing a sunset provision at this time would be bad policy. The advanced services market is developing and changing at a rapid pace, making it impossible to predict what the market conditions will be in the future. To commit to an arbitrary sunset date at this time would needlessly undermine the Commission's flexibility in dealing with this market as it develops and grows. Indeed, establishing a sunset date could actually delay ILEC deployment of advanced services, because by delaying deployment an ILEC could avoid the burdens of creating and operating a separate affiliate, and therefore might simply deploy such facilities after the sunset date had passed -- while at the same time continuing to "stonewall" potential competitors seeking access to xDSL-compatible loops and other UNEs.

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55 Non-Accounting Safeguards Order, ¶ 205.

56 Sections 272(f)(1) and (f)(2) permit the Commission to extend the § 272 requirements for as long a period as it deems necessary. Moreover, the nondiscrimination requirements of § 272(e) are not subject to sunset.

5. An ILEC advanced services affiliate should be barred from providing service via resale.

One of the chief aims of the NPRM's proposal to permit ILECs to establish "truly separate" advanced services affiliates is to incent ILECs to make UNEs and resale available on reasonable terms -- as the Act has unequivocally required since its passage in February 1996, but no ILEC has yet done. The NPRM reasons that if an ILEC affiliate must interact with the ILEC in the same manner as a CLEC, then the ILEC is more likely to make its facilities and services available in a manner that would permit CLECs to take advantage of them as well, thereby promoting competition. This vision, however, cannot be realized so long as an ILEC advanced services affiliate is wholly-owned -- and therefore wholly-controlled -- by the ILEC or the ILEC's parent. The affiliate requirements the NPRM proposes are simply inadequate to achieve the Commission's purposes.

As the Commission's § 271 proceedings to date make plain, no ILEC has made UNEs, or the operations support systems necessary to order and use them, available in a manner that permits competitors to utilize them in a commercially reasonable fashion. ILECs simply have refused to comply with the requirements of § 251(c)(3), because to do so would permit competitors to provide differentiated local exchange and exchange access services rather than simply mimicking ILECs' local (but not exchange access) offerings -- and would permit them to do so at prices that, unlike resale, would not be tied to ILECs' own prices. The advent of advanced services affiliates such as those the NPRM proposes would in no way incent ILECs to alter their behavior.

Unlike a CLEC competitor, a wholly-owned ILEC affiliate would have no reason to favor UNEs over resale. Most fundamentally, the affiliate would not care that it cannot use

resold services to provide exchange access, and thereby avoid paying acess charges if it offers services subject to those fees. Because the affiliate's ILEC parent has strong incentives to discourage UNE-based competition, the affiliate will naturally and inevitably elect to pursue a resale-based strategy. Further, both the monies that an affiliate pays an ILEC for resold services and the funds that the affiliate takes in by selling its own services at retail flow to the same bottom line: that of the ILEC or its parent company. A wholly-owned affiliate will be indifferent to the price it pays for resold services, as it need not earn enough on those services to in fact show a profit because the ILEC's true "margin" on advanced services will include both its profit on resold services plus any retail margin earned by its affiliate. In short, resale presents the ILEC with the opportunity to engage in a classic price squeeze, because it has bottleneck control over essential inputs to advanced telecommunications services.

Indeed, the ability to resell ILEC services through an advanced services affiliate would provide an ILEC a much more powerful means of engaging in a price squeeze than if it provided advanced services itself. Retail price reductions offered by an ILEC will automatically be passed on to CLECs providing resale services through the wholesale discount provision of § 251(c)(4)(A). However, an ILEC affiliate that was not subject to § 251(c) could engage in retail price reductions to squeeze out other resale competitors without affecting the wholesale rate available to the CLEC resellers.

So long as an ILEC advanced services affiliate is permitted to resell its ILEC parent's services, it is virtually certain to do so, rather than providing services via UNEs. Accordingly, to achieve the NPRM's procompetitive goals, the Commission should rule that in order to be deemed a "non-ILEC," an advanced services affiliate must not resell the services of its affiliated ILEC. Moreover, to deem an advanced services affiliate a "non-ILEC" when it resold

ILEC services would, in effect, allow the ILEC to escape § 251(c) simply by running its operations via a separately incorporated entity (an entity which the ILEC fully controlled). Section 251(h) is specifically intended to prevent such efforts to evade the incumbent-specific provisions of the 1996 Act.

Permitting an advanced services affiliate to utilize UNEs obtained from its affiliated ILEC also is highly unlikely to achieve the NPRM's aims to promote competition. As a preliminary matter, UNEs present essentially the same opportunities for a price-squeeze as does resale, because an ILEC affiliate will be indifferent to the price of UNE inputs and need not earn a reasonable profit on the UNE-based services it sells. Second, an ILEC potentially stands to realize greater profits by continuing to refuse to make UNEs available either to its affiliates or to CLECs than it could earn by attempting to compete in the advanced services market through a "truly separate" affiliate. ILECs currently enjoy a monopoly on the POTS lines that virtually all Americans must use to access the Internet. By continuing to deny CLECs the opportunity to obtain UNEs, ILECs can protect that monopoly, as they have done since the 1996 Act was enacted.

Unless and until an ILEC makes UNEs readily available, it will face no meaningful competition from xDSL-based services, because no CLEC can provide those services without access to ILEC facilities. Accordingly, an ILEC has no real incentive (whether or not the Commission permits it to create a non-ILEC advanced services affiliate) to offer UNEs in compliance with § 251(c)(3), because it would thereby risk losing its monopoly over local exchange and exchange access services. Indeed, as AT&T has shown, the ILECs have sought to implement xDSL services only when they were directly threatened by a competitor that could offer broadband services over alternative facilities, such as cable modems and wireless

technologies.[57] The NPRM's affiliate proposal will not give ILECs any additional impetus to make UNEs available to their competitors. Instead, that goal can best be accomplished by: (i) encouraging the rapid deployment of alternatives to ILEC facilities by avoiding unnecessary regulation of carriers deploying broadband technologies that are not dependent on existing local loops; and (ii) strictly enforcing the unbundling and other requirements that Congress imposed on ILECs in § 251(c).

6. Advanced services affiliates should be prohibited from entering into virtual collocation arrangements with affiliated ILECs.

The NPRM seeks comment on "whether a virtual collocation arrangement is more practical or attractive to an incumbent's affiliate than other competitive LECs, and, therefore, creates an unfair competitive advantage for an advanced services affiliate vis-a-vis other entrants."[58] As an initial matter, an advanced services affiliate may not virtually collocate with its ILEC parent, because virtual collocation necessarily would require that the ILEC perform operating, installation, and maintenance functions for the affiliate. These services are clearly prohibited by the NPRM's requirement that affiliates "operate independently."[59] This provision was modeled on § 272(b)(1), which mandates that § 272 affiliates "operate independently" from BOCs, and which the Non-Accounting Safeguards Order held

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57 Comments of AT&T Corp., Inquiry Concerning Deployment of Advanced Telecommunications Capability, CC Docket No. 98-146, pp. 6-11 (filed Septemer 14, 1998).

58 NPRM,¶ 101.

59 See id., ¶ 96 ("the incumbent may not perform operating, installation, or maintenance functions for the affiliate") (citing Non-Accounting Safeguards Order, ¶ 158).

> precludes a section 272 affiliate from performing operating, installation, and maintenance functions associated with the BOC's facilities. Likewise, it bars a BOC or any BOC affiliate, other than the section 272 affiliate itself, from performing operating, installation, or maintenance functions associated with the facilities that the section 272 affiliate owns or leases from a provider other than the BOC with which it is affiliated.[60]

Even if it were not otherwise prohibited, an affiliate should not be permitted to virtually collocate because it would enjoy inherent advantages over CLECs by entering into such arrangements. A virtual collocator is dependent on the ILEC for repair and maintenance. Many CLECs strongly prefer to control these functions themselves, both to keep their costs down and to gain greater control over the quality of the services they can offer.[61] An ILEC affiliate, however, will have no reluctance to cede these functions to the entity that owns and controls it. In addition, virtual collocation typically is less expensive than physical collocation, and an ILEC affiliate therefore could take advantage of virtual collocation arrangements that might be unattractive to its competitors in order to interconnect at a lower cost than CLECs.

To the extent that an advanced services affiliate seeks to deploy facilities in ILEC central offices or remote terminals, it must do so in one of two ways: (i) through physical collocation on the same terms available to CLECs; or (ii) via "cageless collocation" arrangements in which the affiliate performs operating, installation, and maintenance functions on its own behalf

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60 Non-Accounting Safeguards Order, ¶ 158.

61 See, e.g., Nick Wingfield, No Mercy: Covad Communications Needs The Bells' Cooperation to Thrive; It Says It Isn't Getting Much, Wall Street Journal, September 21, 1998, at R-10(concerning Covad's efforts to provide xDSL services in Pacific Bell territory: "virtual collocation isn't acceptable to [Covad], since it wouldn't have control over its equipment").

(or uses a contractor for these services that is not an ILEC affiliate).[62] If an ILEC permits its own affiliate to obtain cageless collocation, then its fundamental nondiscrimination obligations clearly would require it to permit CLECs to do so as well. Similarly, ILECs' nondiscrimination obligations require that the Commission prohibit an ILEC's affiliate from physically collocating in any ILEC facility in which there is not adequate space to permit CLECs to physically collocate there.[63] Such a rule is essential to ensure that CLECs are not completely excluded from obtaining access to ILEC-controlled network elements in certain central offices and remote terminals.

C. Comments On Proposed Restrictions On Transfers Between ILECs And Their Advanced Services Affiliates.

1. Transfers of advanced services facilities, like transfers of any other unbundled network element, render an affiliate an "assign" of the ILEC.

The NPRM seeks comment on whether, or to what extent, an ILEC should be allowed to transfer advanced services facilities to its affiliate without causing the affiliate to be considered an "assign" of the ILEC, and therefore also an ILEC pursuant to § 251(h).[64] The Commission's prior orders make clear that all such transfers, without exception, will cause the affiliate to be deemed an assign, making such facilities subject to § 251(c). Moreover, as the Commission already has found, it is without authority to forbear from enforcing this rule, through the creation of exceptions or otherwise. Allowing so-called de minimis transfers would serve no

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62 See generally infra Section III.C.3 (discussing cageless collocation).

63 See NPRM, ¶ 131 (suggesting that ILEC affiliates should be prohibited from collocating switching equipment in a central office when there is only enough room to permit one carrier to collocate such equipment).

64 See id., ¶¶ 105-112.

purpose other than to grant a windfall to ILECs, which would thereby be allowed to shield the most-advanced portions of their existing telecommunications networks (purchased with funds from regulated services) from the resale and unbundling obligations of the Act. Such a policy would fly in the face of Congress' rationale in adopting § 251(c).

The Non-Accounting Safeguards Order concluded, and the Commission has repeatedly affirmed, that "if a BOC transfers to an affiliated entity ownership of any network elements that must be provided on an unbundled basis pursuant to section 251(c)(3), we will deem such entity to be an 'assign' of the BOC under section 3(4) of the Act with respect to those network elements."[65] The Commission did not adopt exceptions of any kind to this rule, which it specifically applied to all BOC affiliates, not merely those subject to § 272. Moreover, the Commission's recent Section 706 Order held that "all equipment and facilities used in the provision of advanced services are 'network elements' as defined by section 153(29)," and thus must be provided on an unbundled basis pursuant to § 251(c)(3).[66] These rulings represent the Commission's well-reasoned conclusions as to the requirements Congress imposed in the 1996 Act, and it has no basis to abandon them in the case of "advanced services," which the Commission has correctly found that the Act regulates in the same fashion as other telecommunications services.[67]

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65 Non-Accounting Safeguards Order, ¶ 309 (emphasis added); see also 47 C.F.R. Pt. 53, § 53.205 (same language). Ameritech Michigan Order, ¶ 373 (reaffirming rule regarding transfers of network elements).

66 NPRM, ¶ 57.

67 See, e.g., Central State Motor Freight Bureau, Inc. v. I.C.C., 924 F.2d 1099, 1109 (D.C. Cir. 1991) (agency must provide "cogent reasons" for departing from its prior rulings).

Because all advanced service facilities are "network elements," the Commission's existing regulations dictate that a BOC transfer of "any" such facilities to an affiliate will cause that affiliate to be deemed an "assign" of the BOC. Nor does the Commission currently have authority to forbear application of these § 251(c) obligations for transfers of network elements that might be characterized as "de minimis."[68] As the Commission already has concluded, its forbearance authority in this area is circumscribed by § 10(a), which on its face specifies that "[e]xcept as provided in section 251(f), the Commission may not forbear from applying the requirements of section 251(c) ... until it determines that those requirements have been fully implemented."[69] It is beyond cavil that no ILEC has fully implemented the requirements of sections 251(c), and the Commission therefore has no authority to forbear from enforcing that section as to any category or class of ILEC facilities.[70]

If the Commission nonetheless attempts to adopt a de minimis exception to its existing rules, any such transfers should be subject to the same § 272(c) nondiscrimination obligations that the Commission has already determined are appropriate in the case of BOC transfers to § 272 affiliates. The Non-Accounting Safeguards Order expressly held that a BOC could not transfer any "unique facility" to its § 272 affiliate, unless it ensured that the transfer took place in an "open and nondiscriminatory" manner, so that "unaffiliated entities have an equal

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68 See NPRM, ¶ 108.

69 See id., ¶¶ 69-79.

70 ILECs should not be heard to argue that prohibiting transfers of facilities they now use to provide advanced services will somehow interfere with their ability to serve existing customers. An ILEC will retain the option of continuing to offer advanced services itself, subject to the Act's ILEC requirements.

opportunity to obtain ownership of this facility."[71] Items such as loops, collocation space, and DSLAMs that are already installed in ILEC central offices or remote terminals plainly are "unique facilities" in that no CLEC can hope to replicate them without extraordinary expense and effort. There is simply no reasoned basis to suggest that ILEC transfers to advanced services affiliates should somehow be made exempt from this nondiscrimination requirement by permitting an ILEC to favor its affiliate by locking out all other potential purchasers. Any such exemption would contradict the central tenet of the NPRM by allowing the ILEC to favor its affiliate over all other competitors, rather than placing CLECs and ILEC affiliates on an equal footing. Moreover, eliminating this nondiscrimination requirement would virtually guarantee improper subsidization of the affiliate by allowing the ILEC, not the market, to set the value of transferred facilities.[72]

Finally, if the Commission does allow ILECs to "transfer" facilities to their affiliates, ILEC affiliates should not be permitted merely to leave existing advanced services equipment in place on ILECs' premises, but should be required to establish collocation arrangements on the same terms as CLECs.[73] Collocation space is by its nature limited, and even now, at this very early stage of CLEC deployment of collocated equipment, CLECs frequently are advised that collocation space is unavailable. Even where collocation space is available, CLECs

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71 Non-Accounting Safeguards Order, ¶ 218.

72 It is also clear that any definition of what level of transfer would qualify as "de minimis" would be largely arbitrary, and that setting proper values for such transfers and policing compliance with the rules necessary to govern them would pose a major administrative burden for the Commission and for state commissions.

73 If the Commission does permit ILEC affiliates to leave advanced services equipment in place, then at minimum the affiliate must impute the costs of installing that equipment at the same rates that CLECs would pay for cageless collocation.

routinely are forced to wait months before they can actually occupy it. To allow affiliates to leave embedded facilities in place would, in effect, guarantee them collocation space, and would allow them to collocate immediately while CLECs are forced to wait. That outcome would be clearly anticompetitive, and finds no support in the Act or the Commission's prior rulings.

2. CLECs must receive the same intellectual property rights as ILEC affiliates for purposes of making use of UNEs.

Several ILECs have refused to provide CLECs with access to UNEs unless and until the CLEC negotiates separate licensing agreements with third-party vendors whose intellectual property rights purportedly could be implicated by such access. In a proceeding pending before the Commission, AT&T has demonstrated that, to the extent the intellectual property rights of third-party vendors truly are impacted by an ILEC's sale of UNEs, the Act requires the ILEC to renegotiate its arrangements with these vendors so that CLECs can receive the same quality of access to these UNEs that the ILEC itself enjoys.[74] Similarly, the Commission should make clear in this proceeding that, insofar as an ILEC advanced services obtains the right to access intellectual property embedded in a UNE, CLECs necessarily must be able to obtain that UNE on the same terms and conditions. Any other rule would permit ILECs to discriminate in favor of their own affiliates.

It is readily foreseeable that some ILECs' licenses to use intellectual property may also cover the ILECs' affiliates, including any advanced services affiliates that the ILECs create. However, an advanced services affiliate cannot be said to be "truly separate" if its relationship

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[74] Petition of MCI for Declaratory Ruling, Comments of AT&T Corp., CC Docket No. 96-98, CCBPol 97-4, at 10-17 (filed Apr. 15, 1997).

with an ILEC permits it to receive UNEs on more favorable terms and conditions than are available to CLECs. That such discrimination might result from pre-existing contractual arrangements entered into by the ILEC makes it no less objectionable under the Act.

For these reasons, the Commission should require that before an ILEC advanced services affiliate may purchase or use any ILEC UNE, the ILEC must warrant that CLECs can use the intellectual property associated with those UNEs on precisely the same terms and conditions as its affiliate. It is imperative that ILECs ensure that their intellectual property licensing arrangements concerning these UNEs allow CLECs to receive them free of any potential infringement claims by the third-party vendors. Further, it is not enough for ILECs to assert that their affiliates will, like CLECs, be required to obtain separate licenses from the third-party vendors. By virtue of an ILEC's relationships with its vendors, an ILEC's affiliate is in an inherently better position vis-a-vis those vendors than any CLEC, and likely would be able to acquire any such licenses on terms and conditions more favorable than those available to CLECs.

D. State Regulation of Advanced Services Affiliates.

The NPRM states that "[t]o the extent that an advanced services affiliate provides advanced services on an intrastate basis, we encourage states to treat the affiliate equivalently to any other competing carrier offering advanced services."[75] This position is directly at odds with the Commission's previous ruling in the Non-Accounting Safeguards Order, which explicitly recognized that states may have an interest in regulating § 272 affiliates differently than other

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[75] NPRM, ¶ 116.